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THE NATIONAL CITY BANK OF NEW YORK

1924

# Economic Conditions
# Governmental Finance
# United States Securities



New York, November, 1924

## General Business Conditions

THE business situation has shown no marked development in October, but apparently the tendency is in the right direction and expectations are strong. September was considered rather disappointing at the time, but as tangible figures of production, trade and transportation have been gathered they have shown general gains over August, which itself showed decided signs of improvement over previous months. The Federal Reserve Board's summary of industrial conditions for September reports larger working forces in nearly all reporting industries, and the Board's index of production in basic industries, adjusted to seasonal variation, rose 9 per cent in the month.

Pig iron production in September was 2,053,264 tons, the highest since May, although still very low compared with the capacity of the industry, and the output of steel was about 2,800,000 tons, the highest since April. Unfilled orders of the United States Steel Corporation gained 184,000 tons in the month, and were 286,718 above the figures of July 31st, when they were at the lowest point in thirteen years. The steel industry has been passing through a period of real depression since last Spring, but the low point in orders was touched in May, each month since having shown improvement. Prices have been unsettled by the abolition of Pittsburg plus, and this unsettlement may have had some influence in holding up orders. The steel companies have had lean earnings in the second and third quarters.

Notwithstanding the admitted depression in steel and certain other industries, the general volume of business has been large throughout the year. One of the reliable indexes to the volume of trade is the statement of debits to individual accounts, made by member banks to the Reserve banks weekly, and summarized monthly in the Reserve Bulletin. The following are the figures for these debits monthly, for eight months, in 1923 and 1924, and weekly for September and October in comparison with the corresponding weeks of last year:

**Payments Through Banks**

| | 1924 | 1923 |
|---|---|---|
| January | $41,498,264,000 | $41,752,913,000 |
| February | 37,397,792,000 | 35,925,212,000 |
| March | 40,739,481,000 | 42,185,143,000 |
| April | 39,518,668,000 | 39,294,408,000 |
| May | 40,044,354,000 | 40,071,906,000 |
| June | 40,229,841,000 | 40,573,595,000 |
| July | 40,131,073,000 | 36,504,275,000 |
| August | 38,691,819,000 | 33,495,567,000 |
| Week ending— | | |
| September 3 | 8,266,014,000 | 7,404,913,000 |
| " 10 | 9,271,749,000 | 8,305,900,000 |
| " 17 | 10,293,955,000 | 9,712,990,000 |
| " 24 | 9,629,600,000 | 8,801,653,000 |
| October 1 | 10,605,293,000 | 10,064,890,000 |
| " 8 | 10,130,301,000 | 9,145,493,000 |
| " 15 | 9,402,734,000 | 8,793,611,000 |
| " 22 | 10,768,238,000 | 9,185,949,000 |

It will be seen that the figures run close together in the fore part of the two years, but beginning with July this year's figures have been regularly ahead of last year's, which is due in part, however, to a falling off in the last half of 1923.

Car-loadings of freight constitute the best available index to the volume of commodities moving in commerce. From the third week in January to the second week in March the weekly totals of loadings were larger in 1924 than in 1923, but from then to the week ended September 13, 1924, fell behind 1923. Since the week ended August 30, the loadings of 1924 have exceeded those of 1923 by 27,716 carloads, and the loadings of 1923 were far ahead of any previous year. We give the figures for each week since August 30, 1924, and for corresponding weeks of the three preceding years:

| | 1924 | 1923 | 1922 | 1921 |
|---|---|---|---|---|
| Oct. 18 | 1,102,336 | 1,073,095 | 989,889 | 962,292 |
| Oct. 11 | 1,088,462 | 1,085,938 | 969,487 | 906,034 |
| Oct. 4 | 1,077,006 | 1,079,776 | 953,952 | 895,740 |
| Sept. 27 | 1,087,447 | 1,097,493 | 977,791 | 901,078 |
| Sept. 20 | 1,076,553 | 1,060,811 | 961,138 | 873,305 |
| Sept. 13 | 1,061,424 | 1,060,562 | 937,221 | 853,762 |
| Sept. 6 | 920,979 | 928,916 | 823,247 | 748,118 |

The loadings for the week ended October 18, 1924, were the largest for any week in history, and tells a story not only of great business activity but of very high operating efficiency on the part of the railroads.

Moreover, while the loadings of grain in the past month have been the largest on record, merchandise and miscellaneous freight also

surpassed previous records. Coal, coke and ore were under the records of last year, signifying that the iron and steel industry is still a weak member in the industrial circle.

**Textile Industries**

The textile industries are doing better. The cotton mills in September consumed 435,216 bales, which was 22 per cent above August consumption and only about 10 per cent under that for September last year. Operations in October have shown further expansion. Trade in cotton goods has been a little more active, but buyers continue to be cautious in view of the fluctuations in the raw material. The government's last report on the crop raised the estimate to 12,675,000 bales, which compares with 10,128,000 bales, final figures, for 1923. The market showed some confusion on the first day, but rallied and advanced, closing October 30th at 23.33 cents per pound. In the cotton goods trade there is unanimity of opinion that stocks are low and that with assurance against lower prices merchants will buy freely. Exports are large and with the prospect for better times in Europe the available supply of cotton for the coming year does not look formidable. In the Lancashire district, English sentiment is much improved of late, and the mills operating upon American cotton have agreed to increase their weekly time from 26 hours to 32½ hours.

The woolen and worsted industry has been stimulated by rising prices of the raw material, wool being now about 20 per cent higher in the home market than three months ago. The American Woolen Company has advanced prices on fabrics for men's wear several times since its opening, and withdrawn its Spring lines for women's wear as sold out. There are repeated warnings that the world is facing a genuine shortage in the supply of wool.

The silk industry is active with goods prices stronger of late, and manufacturers apparently well supplied with business.

**Building Operators Active**

Every section of the country except the Southwest showed a higher total of building permits in the month of September, 1924, than in September ,1923, which is taken to indicate a larger amount of Winter building in prospect. Orders for railway equipment have been given in increasing volume in recent weeks.

The oil industry, which has been suffering from overproduction, has a prospect of relief, the output having been on a declining scale now several months. Consumption increases steadily, but for the last two years production has kept ahead of it and oil has been relatively one of the cheapest commodities on the market.

Lead is in strong demand, and the price in New York has advanced to 8.65 cents per pound. Copper is at about 13½ cents per pound, but producers are very hopeful of an increasing demand.

The entire business situation has the appearance of waiting with good expectations for something, and the common opinion in business circles is that it wants the presidential election out of the way. That is the next landmark to pass. After it has passed and the fear of radical political changes is allayed, it may be that some people will still hesitate to see what other people are going to do, but, in our opinion the way will be clear for one of the most substantial periods of prosperity this country ever has known.

**The Agricultural Situation**

One of the reasons for this belief is that the industrial equilibrium, so badly disturbed by war conditions, has been practically restored. The agricultural situation is the best in years. With the exception of corn the crops have been large, and as a rule the prices are now remunerative. The Department of Agriculture calculates that as compared with the prices of other commodities they are now as 90 to 100, whereas not very long ago the ratio was as 65 to 100. The Howard-Moorhouse commercial service, which specializes in information about agriculture, makes figures that are still more favorable to agriculture, calculating that the purchasing power of the farmers is now 103 per cent of what it was just before the war.

The wheat crop has been growing with every estimate. The first government report was for about 750,000,000 bushels, and this has been raised each month until the last estimate is 856,000,000 bushels, and there is a prevalent suspicion in trade circles that the final figures will be still higher. The high quality is a very important factor, causing it to overrun in weight and bring premiums over the market price. A report to the "Northwestern Miller" states that in almost the entire territory known as the hard Spring wheat area premiums of 5 to 14 cents per bushel are being paid over the card price. The yields in Kansas and the Southwest were equally good.

The crop has been marketed with unprecedented rapidity. According to the statistician of the Oklahoma state board of agriculture, 72 per cent of that state's production had been sold by September 25th. The strength of this situation has been in the foreign buying. Nat Murray, former government statistician, now with Clement, Curtis & Co., under date of October 24, reviewed the movement as follows:

In July our exports were 40 per cent less than in July last year; in August 5 per cent more than in August last year; September increased 75 per cent, and October exports are expected to be double the

exports of October last year; thus showing a progressive increase in the rate of exports. During the first four months of this year, our exports will amount to approximately 105,000,000 bushels as compared with 74 million in like period last year—an increase of nearly 45 per cent. Our total exports last year were about 156,000,000 and may reach 250 million this season. Our crop this year is high quality and desired by expoters; the quality of the Canadian crop as a whole is relatively poor.

Our wheat has been moving from farms at an unusually rapid rate, first the winter wheat, and now the spring wheat; there is some talk of an embargo on shipments to Duluth and Minneapolis until the congestion at elevators can be relieved. Since July 1 receipts at primary markets have been nearly 100 million bushels larger than in same period last year. This is greater than the increase in the size of the crop and cannot be expected to continue much longer. Notwithstanding this heavy movement the visible increase since July 1 is only 50 million against an increase of 41 million last year, indicating that the movement has been absorbed rapidly.

The price of bread having advanced rapidly in England as a result of the rise of the price of wheat, the House of Commons passed a resolution calling upon the President of the Board of Trade, who is a member of the Cabinet, to account for it. This official in the Labor Government happens to be Sidney Webb, the well-known Socialist writer. Not having heard from the United States that the price of wheat had been boomed by Wall Street as part of the scheme for electing Coolidge, Mr. Webb made an investigation and has reported that the rise of wheat was about what might be expected in view of the outlook for supplies. He said that last year at this time there was superfluity of wheat, while at this time there appeared to be a bare suffiency. Prices, in his opinion, are not so much abnormally high now as they were abnormally low last year.

There is encouragement in this situation to think that prices are not likely to go so low again. The Canadian crop of last year was a phenomenal crop, and may not be repeated in the near future, and the United States will not get this year's yield per acre every year. Russia has fallen down this year, and the opinion now prevails that it will not be a formidable competitor for many years, if ever, for its own population is growing.

The outlook for the price of wheat between now and the next harvest depends upon the crops in Argentina and Australia. If the yields there are good the supply of wheat will balance the estimated requirements of Europe, but if anything goes wrong there, prices will go higher.

## Money and Banking

The credit situation is easy and rates have had no significant change in the last month. Commercial loans of reporting member banks of the New York district on October 15 were $2,332,281,000, against $2,242,612,000 August 27, and $2,192,000,000 the first of June, the latter being the low point of the year. The high point for last Winter and Spring was $2,621,000,000, on March 26. These figures, be it understood, are for the loans not secured by stock or bonds, and for this reason classed as "commercial loans." The designation is not strictly accurate, but it is the best grouping of commercial loans that can be made. At the middle of October, 1923, these figures were $2,275,000,000.

Of this class of loans, the reporting member banks of the entire country, on July 2, held $7,821,389,000, and on October 15 the total had risen to $8,206,415,000. This is the highest total since 1921, and the rise betokens a gradual expansion of business.

It is, however, when we include the investments of reporting member banks, that the most significant figures are found. On October 17, 1923, the total of loans and investments was $16,472,991,000; at the middle of last February it was $16,420,000,000; at the beginning of June it was $16,662,000,000. Since then it has been growing as shown by the following figures:

| | |
|---|---|
| July 2, 1924 | $17,056,459,000 |
| August 6, 1924 | 17,330,085,000 |
| September 3, 1924 | 17,570,963,000 |
| October 1, 1924 | 18,193,551,000 |
| October 15, 1924 | 18,232,690,000 |

Since October 17, 1923, the increase has been approximately $1,750,000,000, and from June 4 to October 15 it was over $1,500,000,000.

### The Effect of Increasing Supplies of Gold

These figures are recommended to the attention of people who have been led to think that by the policy of paying gold certificates into circulation the natural effect of our gold accumulations has been somehow prevented or neutralized. The fact is that the policy of paying gold or gold certificates into circulation does not alter the potency of the gold so far as member bank lending is concerned. Every accession of gold to our monetary stock quickly becomes the basis of a much larger increase in the volume of circulating credit, unless the gold is used to pay off debts at the Federal Reserve banks.

Our gold importations since the war have been largely used by the member banks in this manner, and this is one reason why the predicted inflation has not occurred. Each dollar so used simply cancelled one dollar of outstanding Reserve credit, whereas each dollar added to the reserves of the member banks would have served as the basis for several dollars of circulating credit.

### Inflation Since June

The above figures show that the volume of outstanding bank credit has been largely increased—inflated—since June. How is this explained? In part by the gold importations

and in part by the policy of the Reserve banks in increasing their holdings of government bonds and paper purchased in the market. This action was prompted in part by the reduction of rediscounts, which deprived them of earning power, and in part by the desire of the Reserve banks, as a matter of policy, to improve their position in the money market. A central bank that has no holdings of either commercial paper or securities which command ready cash, is outside the money market and no factor in it, a position which the Reserve authorities are not satisfied for these banks to occupy.

The effect of the policy of replenishing earning assets by the purchase of commercial bills and government bonds in the open market has been to counteract the action of the member banks in devoting their gold receipts to paying off indebtedness. The following table will show the change in the character of the Reserve bank holdings since January 1st, 1924. The figures are for the consolidated holdings:

| 1924. | Bills Discounted for Members. | Open Market Purchases. | Total Earning Assets. |
|---|---|---|---|
| January 2 | $798,000,000 | $474,000,000 | $1,272,000,000 |
| February 6 | 487,000,000 | 408,000,000 | 895,000,000 |
| March 5 | 488,000,000 | 442,000,000 | 930,000,000 |
| April 2 | 530,000,000 | 479,000,000 | 1,098,000,000 |
| May 7 | 440,000,000 | 397,000,000 | 838,000,000 |
| June 4 | 401,000,000 | 454,000,000 | 856,000,000 |
| July 2 | 369,000,000 | 467,000,000 | 859,000,000 |
| August 6 | 273,000,000 | 557,000,000 | 832,000,000 |
| September 3 | 302,000,000 | 612,000,000 | 915,000,000 |
| October 1 | 267,000,000 | 713,000,000 | 983,000,000 |
| October 22 | 223,000,000 | 752,000,000 | 977,000,000 |
| October 29 | 222,565,000 | 806,765,000 | 1,024,176,000 |

Particular attention is called to the figures since May, the period corresponding to the time of credit expansion.

So long as the gold importations were used to cancel the obligations of the member banks at the Reserve banks, they had no effect at all upon the amount of credit in circulation. The "inflationary" possibilities of the new gold were cancelled. On the other hand, when the Reserve banks began to increase their purchases of paper and securities in the open market the results were just the same as though the member banks instead of paying their debts had made the gold the basis of several times that amount of credit. Every check which a Reserve bank has drawn on itself for these payments has found its way into the reserve account of some member bank and has been the same as gold as a basis for member bank lending.

### What of the Future?

The extreme ease in the money market in recent months has been the result of several causes. One has been gold imports, another the policy of the Reserve banks as described above, and finally, the slackening of industry and trade during several months contributed to the situation.

All of these influences probably have about spent themselves. Gold imports have fallen off, and in view of the European loans being floated in this country are not likely to be resumed in important amounts. The Reserve authorities have built up their earning assets to a considerable sum, and probably will not carry the policy much farther, although this is a mere presumption. If they are done, that factor is eliminated. As to the commercial demand for money we expect it to increase.

There is little unused lending power now at the command of the member banks. It is their policy to keep loaned up close to the legal reserve limit. True, there is an accumulation of funds at the centers which will be drawn upon quickly as demand develops throughout the interior, but these funds are being used in some way, and a movement of withdrawal will be a signal for higher interest rates.

The Reserve banks of course have vast resources in reserve, which ought to stay in reserve, and they probably will advance the discount rates as soon as the member banks begin to rediscount freely. The easy money situation may change very suddenly.

### The Influence of Cheap Money

The inflation of bank credit which has taken place since June 4th, while many people have been confidently saying that there was no prospect of inflation, confirms the lesson long taught by experience, that cheap money will find its way into use. The first use is in the purchase of high grade securities, and as they rise, in the purchase of lower grades. A good market for stocks and bonds promotes construction work, which creates a demand for labor and materials, and gradually activity extends to all kinds of business. We hold the opinion that if nothing occurs in the political situation to disturb confidence, this country will move at a good pace along this line of development.

The good crops in the middle west and south, and the rapid movement at good prices, have exerted an influence on the side of easy money. The "Commercial West" of Minneapolis has compiled figures of the deposits of State banks and trust companies in the Twin Cities on October 10, to correspond with the statements of national banks under the Comptroller's latest call, and shows totals for all banks on that date of $475,791,000, against $401,249,000 on June 30, 1924, and $410,066,000 on September 14, 1923. Figures for Kansas City, Omaha and all midwestern cities make similar showings. Deposits have been piling up in Chicago at such a rate that the Clearing house there is following the example of New York in reducing the rate of interest on coun-

try bank balances, to discourage the inflow of money to that city—or make is less burdensome.

The liquidation of old debts in that region will provide funds for new uses. But, while this liquidation exerts an influence for easy money, the prosperity of that section will stimulate business everywhere, and prosperity always creates a demand for credit. Apparently, the outlook is for higher interest rates as these influences make themselves felt.

## The Bond Market

Next to the German loan the largest issue on the bond market in October was that of the $50,000,000 forty-year 5 per cent secured notes of the Pennsylvania Railroad Company. The loan is secured by pledge of stocks of companies representing the principal component parts of the Pennsylvania system. This loan was a refunding proposition, as the proceeds will be applied upon the debt of the Pennsylvania Railroad Company to the United States Government, upon which the interest is 6 per cent. The offering was readily sold.

The next largest flotation of the month was that of the Swedish national government, consisting of $30,000,000 thirty-year gold bonds, due November 1, 1954, with interest at 5½ per cent, offered at 99½, to yield a little better than 5½ per cent. This offering was a great success, much interest being shown in all parts of the country.

The market for United States securities was very firm during the month of October. The Treasury 4¼ per cent bonds optional 1947 due 1952 sold at 107 and interest, representing a new high for this issue for all times. The tax exempt Liberty 3½s advanced ¼ of a point, the Liberty Third 4¼s, due 1928, ⅛ of a point, with practically no change in the other Liberty issues. The principal reason for the strength was the continued ease in money conditions. In addition, there was very good Western buying following the reduction in the rediscount rate by the Federal Reserve Bank of Minneapolis from 4½ per cent to 4 per cent.

The Dow Jones figure for the combined average of 40 bonds (10 high grade rails, 10 second grade rails, 10 industrials, and 10 public utilities) was 90.88 on October 25 as compared with 90.76 on September 23 and 87.25 on February 28.

The aggregate of issues in October was large, and as a rule they went off readily. Following is a list of the more important issues in the order of their offering:

| | |
|---|---|
| $20,000,000. | Paris-Lyons-Mediterranean R. R. Co. External S. F. Gold 7s, due Sept. 15, 1958, price 93¾, to yield over 7.55%. |
| 50,000,000. | Pennsylvania R. R. Co. 40 Year Secured 5s, due November 1, 1964, price 98¼ and interest, to yield 5.10% to maturity. |
| 5,000,000. | Public Service Co. Northern Illinois First Lien & Ref. Series "B" 5½s, due July 1, 1964, price 96 and interest, to yield over 5.75%. |
| 12,500,000. | United Drug Co. 20 Year Gold 6s, due October 15, 1944, price 99¾ and interest, to yield 6.04%. |
| 11,700,000. | Continental Gas & Electric Corp. Sec. "A" 6½s, due Oct. 1, 1964, price 99 and interest, to yield over 6.55%. |
| 7,000,000. | Finnish Guaranteed Municipal Loan of 1924, $3,900,000 Associated Municipalities Series "A" and $3,100,000 City of Helsingfors Series "B" 30 Year Ext. 6½s, due October 1, 1954, price 91 and interest, to yield over 7.23%. |
| 15,000,000. | Nord Railway Co. Ext. S. F. Gold 6½s, due October 1, 1950, price 88½ and interest, to yield over 7.50%. |
| 9,000,000. | Ohio Public Service Co. 1st & Ref. Series "D" 5s, due Sept. 1, 1954, price 89 and interest, to yield over 5¾%. |
| 7,000,000. | Republic of Peru Sanitation Loan Series 1924, External S. F. Secured Gold 8s, due October 1, 1944, price 99½ and interest, to yield 8.05%. |
| 5,458,000. | Allegheny County, Pa., 4¼% Bonds, due 1925-1954, offered at prices to yield 3.50% for the 1925-28 maturities and 3.95% for the 1925-54 maturities. |
| 6,000,000. | City of Bogota, Republic of Columbia, S. F. External Gold 8s of 1924, due October 1, 1945, price 98 and interest, to yield 8.20%. |
| 12,500,000. | Detroit Edison Co. Gen. & Ref. "A" 5s, due Oct. 1, 1949, price 97½ and interest, to yield about 5.18%. |
| 110,000,000. | German External Loan, 1924, Gold 7s, due October 15, 1949, price 92 and interest, to yield 7.70%. |
| 5,000,000. | Minneapolis Street Railway Co. 1st Mtg. Coll. 5½% Notes, due Aug. 15, 1928, price 100 and interest, to yield 5½%. |
| 12,000,000. | Pan American Petroleum & Transport Co. 10 Yr. Conv. S. F. 6s, due Nov. 1, 1934, price 97 and interest, to yield 6.40%. |
| 15,000,000. | Wheeling Steel Corp. 1st & Ref. S. F. "A" 5½s, due July 1, 1948, price 96½ and interest, to yield over 5.75%. |
| 15,000,000. | Cuban Dominican Sugar Co. 20 Yr. 1st Lien S. F. 7½s, due Nov. 1, 1944, price 97½, to yield about 7.75%. |
| 6,000,000. | Los Angeles Gas & Electric Corp. Gen. & Ref. "I" 5½s, due Oct. 1, 1940, price 96½ and interest, to yield over 5.75%. |
| 30,000,000. | Swedish Government 30 Year Ext. Loan 5½% Gold Bonds, due November 1, 1954, price 99½ and interest, to yield over 5.50%. |

## The German Loan

Measured by its significance for human welfare the German loan issued in the past month for the purpose of inaugurating the operations of the Dawes plan may be counted one of the great international events of all time. Six years have passed since the armistice was signed—six years spent in fruitless wranglings while the people waited in misery, and now a simple plan devised by bankers and business men goes into effect.

The loan was planned to yield approximately 800,000,000 gold marks (about $190,000,000 to the German Treasury, and was apportioned to the public markets of nine countries, to wit, the United States, Great Britain, France, Belgium, Italy, Sweden, Switzerland and Germany. The portion for each country is in the language and monetary terms of that

country. The portion assigned to the United States was $110,000,000; the portion to Great Britain, £12,000,000 (approximately $54,000,000 at the present rate of exchange), and the remainder went to the other seven countries.

The principal purpose of the loan is to provide a gold basis for the monetary system of Germany, in order that the industries and business of the country may have a firm foundation. The new Central bank of Germany is required to maintain a gold reserve of 40 per cent, but this will enable it to issue currency notes or other credits to 2½ times that amount.

### Terms of the Loan

The security for the bonds is described as follows:

1. A direct and unconditional obligation of the German Government chargeable on all the assets and revenues of that Government.

2. A specific first charge on all payments provided for under the Plan of the Dawes Committee to or for the account of the Agent-General for Reparation Payments, such charge being prior to reparation and other Treaty payments which in turn have a specific precedence over the existing German debt.

3. A first charge by way of collateral security on the "controlled revenues"—i.e., the gross revenues of the German Government derived from the Customs and from the taxes on tobacco, beer, and sugar, the net revenue of the German Government from the spirits monopoly, and such tax (if any) as may hereafter be similarly assigned by the German Government in accordance with the terms of the final Protocol of the London Conference.

The "controlled revenues" are estimated as amounting annually to not less than 1,000,000,000 Gold Marks (approximately $240,000,000). The German Government may not create any further charge upon the controlled revenues ranking prior to or equally with the charge created in favor of the bonds of the loan.

In the London Protocol, the Governments of Belgium, Great Britain (with the Governments of Canada, Australia, New Zealand, South Africa and India), France, Greece, Italy, Japan, Portugal, Roumania and Jugo-Slavia, agreed as follows:

In order to secure the service of the loan of 800 million gold marks contemplated by the Experts' Plan, and in order to facilitate the issue of that loan to the public, the signatory Governments hereby declare that, in case sanctions (penalties) have to be imposed in consequence of a default by Germany they will safeguard any specific securities which may be pledged to the service of the loan.

The signatory Governments further declare that they consider the service of the loan as entitled to absolute priority as regards any resources of Germany so far as such resources may have been subjected to a general charge in favor of the said loan, and also as regards any resources that may arise as a result of the imposition of sanctions.

At the London Conference, the Allied Governments adopted a resolution reading as follows:

The Allied Governments, desiring that this loan should be successfully raised, and contemplating that the loan will be a first lien on the security pledged thereto, will invite the Central Banks in their respective countries to use their good offices to facilitate the placing of the loan.

The security specifically pledged, besides the controlled revenues, consists of the entire railway system of Germany, valued at $7,500,000,000, and first mortgage bonds to the value of 5,000,000,000 Gold Marks (about $1,250,000,000) on the principal industries of Germany.

For the purpose of providing the necessary foreign currencies for the service of the Loan, the German Government, the Reparation Commission, the Transfer Committee and the Agent-General for Reparation Payments have agreed that funds required to be sent abroad for that purpose shall have an absolute right of remittance, which right shall have priority over the remittance of funds required to be remitted in discharge of reparation payments or other liabilities.

### The Moral Pledges

It is certain that a loan never was more amply secured, assuming that the settlement is a final one or that any subsequent alterations in the agreement are amicably made, with due regard for the new equities which the loan creates. The only question that anybody has raised relates to the possibility of a dispute that would lead to a renewal of warfare, which is extremely improbable. Both parties to the reparation settlement are bound in honor to safeguard the holders of the loan against loss from any such action on their part. The international character of the loan, the number of countries participating in it, the constructive purpose for which it is made, altogether give it claims to the highest consideration. To question that its claims will be respected under any circumstances is to express a cynical doubt as to the possibility of any international cooperation.

### Yield and Terms of Redemption

Nevertheless, the loan is a large one and had to be offered on the general public market, where these conditions might not be fully understood, hence the terms are high for good security. The loan is for 25 years, the coupon rate 7 per cent, and the bonds went to investors at 92, the yield to maturity being about 7.70 per cent per annum. In comparison with the Swedish loan, yielding slightly over 5½ per cent, also floated in this market last month, the difference signified that the first German loan after the war was to some extent an experiment.

The loan will run to maturity, except for the retirements made under the operation of the sinking fund. The German government pays off the loan monthly, beginning November 1, 1924, at the rate of $4,620,000 per year, which is one-twenty-fifth of the issue, at the rate of

105, by purchases through the sinking fund. The purchases will be made by lot at 105 and accrued interest, unless the bonds can be bought in the open market at a lower price.

### The Public Reception

The offering in New York was immediately oversubscribed, the books being closed in ten minutes. The offering in London and upon most of the European markets went off in about the same manner. The London Times of the 17th said:

> Eliminating war loans, nothing in its class has equalled the success of the German loan since the issue of the Transvaal Guaranteed Loan more than 20 years ago. The Swedish portion of the issue, which was offered yesterday, also met with a very ready response, the amount being over-subscribed within half an hour.

The reception accorded this loan everywhere is the best of evidence of Europe's confidence in the stability of the settlement, and it is in every way gratifying that the financial markets of the world should give this hearty response to the appeal for aid in placing Germany upon her feet and in position to discharge the obligations she has agreed to.

### The Collaborating Bankers

Something of this feeling is expressed by the London Times in the following paragraph, written after the work of the bankers was completed:

> A point that is not without its importance for the future is that the bankers of nine countries have, by a commendable display of good will, been able to thrash out all the details of a big complex financial operation, full of knotty problems—in some part due to the financial stringency in Europe—within about a fortnight of the opening of negotiations. It could not have been achieved without those concerned being actuated by a willing spirit of co-operation and a desire to take broad views in tackling what every one knew to be one of the most difficult reconstruction problems in Europe—not less formidable because it was inextricably mixed up with a variety of political considerations and prejudices. No such gathering of international bankers as met at the Bank of England on October 10 to put their signatures to the loan contract has ever been held before. The successful conclusion of their labours marks a big step, in the moral as well as in the material sense, towards the rehabilitation of the economic life of Europe.

### A British Banker's View

Mr. Henry Bell, of Lloyd's Bank, London, one of the most eminent British bankers, speaking before the Associated Industries of Massachusetts, last month gave utterance to opinions and sentiments which are so representative of the attitude of that much misrepresented group, the "international bankers," that we are pleased to make the following quotation. After describing the grievous disorganization of finance and business in Europe and the difficulties of achieving progress in readjustment at earlier after-war conferences, as at Brussels and Genoa, he said in part:

> Since 1922 the darkness has lifted. Austria and Hungary have been taken in hand. Now Germany is to be assisted. It has been my duty to study the Dawes report very closely, and I have no doubt that its recommendations should be carried out. It will create difficulties, but these will be temporary, and readjustments will act both ways. To improve a rival's currency is to strengthen her competitive capacity. Possibly; but we were told that collapse of her currency, by enabling her to under-pay her workers, was to our disadvantage. To grant her a loan will enable her to sell in competition with us—but to buy also. In any long view, the prosperity of all is cumulative, *and six men or 600,000,000 are only harmed by the defection or failure or folly or misery of part of their number.*
>
> Throughout the Dawes report there is no implication that a better financially-ordered Germany would be a menace. The definite pronouncement is strongly otherwise, and I entirely agree. If Germany can, as result of financial assistance, make and sell her goods, she must buy from others, and the more she sells, the more she must buy.
>
> Germany has to pay great sums. The total is still nominally about $33,000,000,000. That is beyond her capacity. It must one day be adjusted at some possible lower figure. But the first program of payment has been accepted by Germany, and an elaborate system of controls established.
>
> To assist Germany in making payments, the world is to lend Germany $200,000,000. Of the security of the loan there appears to be, in all human probability, no doubt. There is so much "behind" it that the bonds, at suitable terms, should be a very safe investment.
>
> It is the latest and greatest effort to rebuild prosperity, not only for Germany but, it is hoped, for the world. And now I turn to that greater matter than all, the efforts to effect the world's betterment.

After reviewing war and armament costs, Mr. Bell continued:

> Actual expenditure on armament has decreased, but the great debts of war remain. Nothing but work will remove them; no ingenious solution will provide a substitute. But work is not the greatest of the tired world's needs. Man cannot work if he cannot and will not live in peace.
>
> How long will we tolerate the sin, the folly of war? I hold it right to resist aggression by my life, my all. But cannot the wisdom of man make the most aggressive shrink from antagonizing an outraged and determined world? Can we not in every act and word call on our fellowmen to accept the lawful arbitrament of just men on the rights and wrongs of passing quarrels? If not, and once again there is that "next great war," there will be no rehabilitation, no more patient conferences and committees, no remedial loans.
>
> May I plead for your help to build up, and not to stand aside; to pity, not to censure; to speak, not to keep silence? I know how much you have done—help Europe all you can.

## Publication of Income Tax Payments

The making public of income tax payments is a sign of the increasing strength of the movement for the suppression of individualism and the extension of mass authority over what in the past have been considered private affairs. It is improbable that the publication will be of any importance in aiding collections. The competitors, acquaintances and relatives who scan the lists are much more likely to be interested in the information for what it may be worth to themselves than from any interest to aid the government. Moreover, in view of the amount of tax-exempt income and the various lawful offsets against income in any

given year, figures that are unexpectedly low have little real significance to readers who do not know the details of a report.

It has been the opinion of experts in taxation that the revenues from income taxes are increased by treating the information about individual incomes as confidential. People generally resent publicity in such matters as a needless and unjustifiable violation of privacy, and are more likely to be prompted to evasion by this feeling than by unwillingness to pay the tax.

The probable intent of those who advocate this publicity is to foster envy and class hatred and stimulate the agitation for a leveling of incomes. "Why should a few have so much when the many have so little?"

#### The Real Destination of Large Incomes

The answer is that in reality the few do not have what is represented as going to them, at least in any such sense as commonly understood. The United States Steel Corporation heads the list of income taxpayers, but it has 150,000 stockholders who share that portion of its income which is distributed, while the important portion which is not distributed is used for improving the industry, to the advantage of the public. The second largest taxpayer is the Ford Motor Company, ownership of which happens to be almost entirely in one family, but this company furnishes an even more striking demonstration of the fact that these incomes do not signify great sums devoted to a few. The portion of its income which is devoted to the Ford family is insignificant, the great bulk of it from the beginning to this day having been devoted to the development of an industry giving livelihood to thousands of families and supplying hundreds of thousands of people with a convenient and helpful means of transport.

The implication throughout the agitation against large incomes is that the owners are without good right to them, that they are withdrawn from a common fund, and that the taxation aimed at them only partially accomplishes a just distribution. An analysis of the real distribution of almost any one of the large incomes will show the falsity of all this. The Ford income illustrates it with unusual effect because the nominal beneficiaries are so few and their personal share is slight. The Ford Motor Company and the members of the Ford family paid something over $19,000,000 in Federal taxes last year, and this may be compared with what was withdrawn from the industry by the Ford family for personal expenditures.

What would have become of the $19,000,000 if it had not been taken by the Federal Government? Would the Ford family have increased their personal expenditures? Probably not. Most likely the Ford industries would have gotten it, the Ford pay-rolls would have been that much larger, and the Ford plans for revolutionizing industry would be that much farther along. Is the fact that $19,000,000 were lost last year to these purposes a matter for public congratulation? Would it have been advantageous to the public if taxes running up to one-half his net income had been levied upon Mr. Ford from the beginning of his career?

#### Leveling Downward

And so it will be found as individual cases are examined that the agitation to equalize incomes is, in its effect, an agitation to equalize the power, the efficiency and influence of individuals upon a common level, which of course would have to be the level of the lowest. It is an agitation to destroy leadership by depriving it not only of its legitimate rewards, but of the means by which it accomplishes its service.

The public is more familiar with what Mr. Ford does with his surplus income than with what most other men do with their's, but whether surplus incomes are large or small, and whether they are invested in industries owned and controlled by themselves or invested in the bonds or stocks of a corporation like the United States Steel Corporation or the American Telephone and Telegraph Company, which has 340,000 stockholders, or the Pennsylvania Railroad Company, which has 145,000 stockholders, or in any of the thousands of enterprises, corporate or individual, which are carrying on the business and developing the industries of the country, the principle is the same. The surplus incomes are devoted to public purposes as truly as though they were owned by the State.

The third tax-payment in size as reported was that of Mr. John D. Rockefeller, Jr. His fortune is closely associated with that of his father, and the general uses to which it is ultimately dedicated are well-known. In the history of private benefactions those coming from this source have been unequalled for the scope of their benefits or the wisdom of their management. It is quite certain that not one dollar of the $7,000,000 tax collected in this case was taken from that portion of this income which was destined to serve the personal wants of the recipient; that is to say he did not curtail his personal expenditures in order to pay it. The effect inevitably was to reduce the sum available for public purposes.

## The Federal Reserve System

The campaign will be closed and election over before this issue of the Monthly Letter will have reached its readers, hence whatever

comments are made herein upon matters that have been at issue in the campaign are made for after-consideration. The best time to discuss matters of public policy is when no election is immediately pending, and the questions may be detached from partisan politics.

In our July number we referred to the general character of campaign discussion and its inevitable tendency to sacrifice everything else for the sake of immediate influence upon the voters. The educational value is lamentably small, for one reason, because so few people are really receptive to instruction at the time, and also because the output of alleged information is so poor in quality and overwhelming in quantity that the most earnest seekers for the truth would have difficulty in finding it.

We predicted then that the Federal Reserve banking system would be one of the main targets of attack having misgivings that the fire would come from all sides. This proved to be the case. Of course the La Follette party would attack it; that was a foregone certainty. Every movement against organized society attacks the banking system, because it is taken to be the visible agency of the hated "money-power."

**The Reserve System the Goat**

Moreover, the Federal Reserve system has had to take the brunt of the criticism and blame which inevitably falls to somebody whenever great numbers of people have to suffer losses or inconvenience. There always has to be a "goat" for such times, and when the great post-war price slump came, extending around the world, and great numbers of people in the United States, as elsewhere, suddenly became "hard-up," the Federal Reserve system was precisely in position to play the part for this country.

Of course the true explanation of the great fall of prices is to be found in the great rise of prices which preceded, and which was caused by the war. It is a matter of history that war always causes high prices and that prices always slump afterwards. Probably every man who was caught with high-cost goods or property on his hands and heavy indebtedness outstanding knew when he made the purchases and incurred the indebtedness that a slump would sooner or later follow the boom, but he wasn't looking for it just when it came.

A slump would have come no matter what political party had been in power or what the management of the Federal Reserve system might have been. The truth is, however, that although the Federal Reserve banks were very much hampered by reason of policies forced upon them by the exigencies of Treasury financing, they rendered enormous services to the country during the crisis. If anybody thinks the crisis was as bad as it might have been, he will do well to think of what the situation would have been if the local banks from the Atlantic to the Pacific had suspended cash payments as in 1907.

**Limitations of the Reserve System**

The Reserve banks were not able to prevent prices from falling in the United States when they were falling all over the world, or to save a great many people from the necessity of taking losses on their holdings. Moreover, there was a limit to the amount of credit the Reserve banks could provide, and they had the responsibility not only of keeping the member bank borrowings within that limit but of seeing that the borrowing banks kept themselves in condition to meet their obligations. In other words, it was necessary for the Reserve banks, the mainstay of the nation's credit system, to protect their own solvency. The first obligation of any and every banking institution is to keep itself in position to meet its own obligations; even a government-owned bank would have to do that.

Out of this situation developed a popular outcry against the Federal Reserve banks, and it is a regrettable fact that the political leaders of all parties generally joined in. The Republican and Democratic text-books, as part of the campaign tactics, both accepted the theory that the Reserve banks had forced a great deflation of credit, and this has been cited as proof that such was the case. It does not prove anything but that campaign managers are not interested in combatting popular errors. A campaign manager's task is to find out what is unpopular and place the blame for it on the other party. The campaign speakers commonly followed the same line, Democrats urging that the crisis came under a Republican administration and the Republicans pointing out that the Reserve Board had a hold-over membership from the Democratic administration, and claiming that the policy of deflation was inaugurated under that administration. In some instances conventions adopted resolutions pledging low interest rates and the adoption of various reforms in organization and policies.

**The Alleged Policy of Deflation**

Now what basis is there for the charge that the Federal Reserve Banks deliberately contracted credits, compelled debtors to throw their property on the markets and thereby precipitated the fall of prices and business depression? We have dealt with this subject repeatedly heretofore, but in view of the widespread ignorance of the facts apparent during the campaign it seems worth while to review the history again.

It has been commonly represented that the policy of credit deflation had its inception in

the Summer and Fall of 1919. It has been said by some of the most prominent exponents of the theory to have had its origin in the demands of the railway employes for higher wages to meet the rising costs of living, presented to President Wilson in August of that year. The President urged the railway men not to press the demand and promised to take such steps as lay in the power of the government to lower living costs. The promise was an ill-advised one, because the government has little to do with the cost of living, but the President addressed a special message to the Congress on the subject and caused the Department of Justice to redouble its efforts to discover combinations in restraint of trade and prosecute profiteers wherever found. These efforts accomplished about as much as governmental efforts to regulate prices usually do, which is practically nothing, because the general price level is never materially affected by combinations. The Bureau of Labor price-table stood at 216 per cent of the 1913 level when the President made his speech to Congress and by the following May it had advanced to 247 per cent.

### The Period of Speculation

It has been said that in conjunction with these movements, the Reserve authorities received instructions to begin a general deflation of credit, but there is no warrant for this statement. All experienced observers, however, realized that inflation was running away and that steps should be taken to stop the alternate wage and price advances that were making it necessary to use constantly increasing amounts of credit in the transaction of all business. Price advances stimulate speculation, and speculation itself carries prices higher. War restrictions upon the use of credit having been removed, stock exchange loans in New York ran up to the highest figures ever known, but speculation in stocks was not confined to the exchanges or to listed stocks. It was running riot over the country. Swarms of stock-salesmen were abroad, even in the agricultural districts, selling the stocks of newly-organized companies,—oil companies, meat-packing companies, and fake companies of various kinds—upon commissions which made the companies insolvent from the beginning. Land speculation was running wild, farming lands changing hands repeatedly, at advancing prices, often upon very small payments but creating large indebtedness, the buyers expecting to sell again before the deferred payments came due. An investigation by the Department of Agriculture afterward revealed that the average increase in the selling-value of lands in the State of Iowa from March 1, 1919, to March 1, 1920, was about $63 per acre!

All of this speculation was making demands on the banks for credit and bankers of experience knew that the tendency was dangerous. However, competition between banks for business is so sharp in this country that bankers are reluctant to deny accommodations to desirable customers, for fear they will take their patronage elsewhere. Moreover, they were making loans at from 6 to 8 per cent and rediscounting at the Federal Reserve banks at 4¼ to 4¾ per cent. This relation between Federal Reserve rates and market rates was putting a premium on inflation.

### Warnings by Bankers

Leading bankers uttered public warnings, and on June 20, 1919, Governor Harding of the Federal Reserve Board addressed a letter to each of the Governors of Federal Reserve banks in which he said:

> The Federal Reserve Board is concerned over the existing tendency toward excessive speculation and while ordinarily this could be corrected by an advance in discount rates at the Federal Reserve banks, it is not practicable to apply this check at this time because of Government financing.

The Treasury had issued its Victory loan in May, 1919, at 4¼ per cent interest, far below market rates, and subscriptions had been promoted by an understanding that member banks and Reserve banks would carry loans on this collateral at the same rate. The loan under these conditions represented clear inflation and tied the hands of the Reserve banks for the time being as to regulating interest rates.

The Joint Committee of Agriculture Inquiry, appointed by the two houses of Congress in 1921, to investigate the alleged deflation of credit, reported that had the Reserve banks been free to raise their rates during the Spring of 1919 much of the inflation, expansion and speculation which characterized the following twelve months would have been prevented.

### The Problem of Stopping Inflation

Although it was generally recognized in financial circles that something should be done to check the reckless increase of indebtedness, there was great timidity about dealing with the situation, from fear that industry and general business might be unfavorably affected. The prevailing solicitude upon this point is seen in every utterance and act of the Reserve authorities. The problem as seen by them and by the leading bankers of all sections was how to stop the absorption of credit by speculation without disturbing industry or the general price-level. It was well understood that to disturb the price-level would affect trade and production and although prices were regarded as abnormally high, it was hoped that the restoration of normal conditions over the

world with increasing production would correct the situation gradually. That there was no policy of general credit-contraction is proven by the fact that bank-credits continued to expand, as shown below.

### The Advance of Discount Rates

By November, 1919, the Reserve authorities deemed that time enough had elapsed since the flotation of the Victory loan to warrant them in taking the first step toward control by means of the discount rates. On the 3rd of that month they cautiously advanced the discount rate on paper secured by government war loans from 4¼ to 4½ per cent, other rates remaining practically unchanged. On December 30 the preferential rate on this class of paper was removed entirely, the rate being raised to 4¾ per cent, the same as on 90 day commercial paper. On January 30, 1920, a more positive step was taken, raising the rate on commercial paper to 6 per cent and the rate on paper secured by Liberty bonds and Victory notes to 5½ per cent. The reason for this advance was frankly stated to be the failure of bank credits to show the usual liquidation after January 1st. This was taken as showing that the inflationary tendency was still strong. On February 26, the rate on paper secured by Treasury certificates was raised to 5 per cent, and on June 1, 1920, the final step was taken, raising the rate on commercial paper to 7 per cent, on paper secured by Treasury certificates to 5½ and on paper secured by Liberty bonds and Victory notes to 6 per cent.

This is the record of the steps taken by the Reserve authorities to check credit expansion by raising the discount rates, except that in several of the Western and Southern Reserve banks a system of rationing credit by means of progressive rates upon heavy borrowings was put into effect under the terms of the Phelan act. This measure was intended to give the Reserve banks the power to penalize member banks which were absorbing more than their share of the available credit.

In the January 1921 number of the Federal Reserve Bulletin, the official publication of the Reserve Board, the following summary of the changes in discount rates during the year was given:

> Changes in the condition of the Federal Reserve Banks during the year just passed should be considered in connection with the changes in credit policy originated about the close of 1919 and continued during the year under review. Early in the year the Federal Reserve Banks raised their discount rates on commercial paper, but the influence of the higher rates is seen in retarding the progress of borrowings rather than in restricting them. In fact, total Federal Reserve Bank holdings of discounted bills, 2,321.2 millions at the beginning of the year, increased by over 300 millions up to the end of April, and by another 200 millions during the next four months. The peak of 2,826.8 millions was reached on November 5, while the total held on December 30, 2,719.1 millions, is 487.9 millions larger than the total held at the beginning of the year.

### Volume of Federal Reserve Credit in 1919-20

The final appeal as to whether the Reserve banks forced a contraction of credit in 1919 and 1920 is to the record. A consolidated statement of the condition of the twelve banks is published weekly, and we give below the figures for the "bills discounted" and "total earning assets" at two dates in 1919 and two in 1920. The first date, August 1, 1919, is selected as just before the demands of the railway employes upon President Wilson were presented, these demands being commonly named as prompting the adoption of the policy. The second date, November 7, 1919, was just after the first advance of discount rates, which was accompanied by ample warnings from the Reserve Board, to the effect that it was deemed necessary to put a check upon the constant tendency to an increasing volume of bank credit. The third date, May 7, 1920, is selected as being about the time the general decline in commodity prices began and shortly before the so-called secret meeting was held at Reserve headquarters in Washington, when according to La Follette and Brookhart, the final arrangements for slaughter were made. The fourth date, November 5, 1920, is selected because it marks the high point of Federal Reserve credits, just one year from the date of the first advance in discount rates.

"Bills discounted" consist of rediscounts for member banks. "Total Earning Assets" include rediscounts, bills purchased in the open market and government securities purchased by the Reserve banks on their own account. Of course, all purchases are a means of putting out reserve credits. The figures for the four dates are as follows:

TOTAL BILL HOLDINGS

| Aug. 1, 1919 | Nov. 7, 1919 | May 7, 1920 | Nov. 5, 1920 |
|---|---|---|---|
| $2,222,730,000 | $2,623,075,000 | $2,914,456,000 | $3,126,594,000 |

TOTAL EARNING ASSETS

| | | | |
|---|---|---|---|
| $2,468,086,000 | $2,923,204,000 | $3,214,357,000 | $3,421,575,000 |

These figures show that instead of a contraction of credit following the demands of the brotherhood chiefs in August, 1919, the volume of outstanding reserve bank credit constantly increased over a period of fifteen months, and at the end of that time was nearly one billion dollars, or about 40 per cent greater than at the first date named.

It is of interest in this connection to also know the trend of member bank credits. This is shown by the weekly reports of about 800 of the more important member banks to the

Federal Reserve banks. They show the following figures for the dates named:

| | Loans, Discounts and Investments |
|---|---|
| Aug. 1, 1919 | $14,682,076,000 |
| Nov. 7, 1919 | 15,569,715,000 |
| May 7, 1920 | 17,075,646,000 |
| Oct. 15, 1920 | 17,283,996,000 |

The trend is about the same for these local banks as for the Reserve banks, but the member banks reached the peak about three weeks earlier than the Reserve banks. After November 7 the amount of Reserve bank credit outstanding gradually declined until in the last statement of 1920 it stood at $2,974,836,000, while member bank credits declined until in the last statement of the year it stood at $16,692,152,000.

This decline in the last quarter of the year was itself the result of the fall of prices, decline of industrial activity and general liquidation which by this time was under way. With prices falling, business men stop buying and devote their energies to working off stocks and paying off debts, causing a reduction of bank loans.

### Discrimination Against Farmers

Another feature of the situation in 1920 is worthy of attention. It has been charged that the "money power" deflated the farmers, with especial severity. The truth is that the loans of Federal Reserve banks fell most rapidly in the eastern districts, where the paper was chiefly that of mercantile houses and industrial companies. Moreover, as the condition of these eastern Reserve banks became easier they shifted their lending capacity to the support of the western and southern banks, where the loans to farmers were chiefly held, thus enabling them to grant more credit than they would have been able to out of their own resources.

The Federal Reserve Bulletin for January, 1921, in its review of the operations of the system during 1920, referred to this feature in the following language:

> **Interbank discounting showed a considerable increase about the end of April, when nearly 150 millions of rediscounted bills were carried by the Boston, New York, and Cleveland banks for seven other Federal Reserve banks. After a slight recession these operations were resumed on an increasing scale early in August, and on October 29 the Boston, Philadelphia, and Cleveland banks reported a maximum for the year of over 247 millions of bills held under discount for eight other Reserve banks. At the close of the year total discounts of the above three banks included 115.3 millions of paper discounted for five other Reserve banks in the South and Middle West.**

The report of the Joint Commission of Agricultural Inquiry, created by Congress in 1921, and headed by Congressman Sydney Anderson of Minnesota, dealt with this subject of discrimination against farmers at great length in its report, and its findings ought to be conclusive upon that point. After reviewing the testimony taken, the Commission says (Part II, page 117):

"An analysis of the figures in these studies seems to justify the conclusions:

> **1. That the expansion of bank loans in rural districts during the period of inflation ending June, 1920, was relatively greater than in the industrial sections, taken as a whole.**
>
> **2. That the action of the Federal Reserve Board and the Federal Reserve banks during the 15 months preceding April 28, 1921, did not produce a greater curtailment of bank loans in the rural districts than in the financial and industrial sections.**
>
> **3. Credit was not absorbed by the financial centers at the expense of rural communities for the purpose of speculative activities.**
>
> **4. That the pressure of the forces of liquidation and depression in the agricultural sections was reflected in a reduction of deposits. This reduction of deposits, particularly demand deposits, was relatively larger in the agricultural and semi-agricultural counties in the United States than in the industrial counties.**

### The Fall of Prices

It is important to understand that the volume of Reserve bank credit and of member bank credit continued to increase throughout and after the advance of discount rates to the highest point, and after the general fall of prices had begun.

The prices of live stock began to decline in the latter part of 1919, as exports fell off. Many farmers lost money on the cattle and hogs marketed in the Winter of 1919 and the following Spring. In March a banking and financial crisis occurred in Japan, where inflation had been running about such a course as in the United States, and the silk industry and trade in the United States were seriously affected. In May prices broke on a number of staple commodities. At the wool auction in Boston the 20th prices were 20 to 30 per cent lower than they had been up to that time. The John Wanamaker store in New York startled trade circles throughout the country by advertising a sensational cut on everything in stock. Cancellations became numerous in textile goods and shoes, and the reason was not that merchants could not get credit, but that sales were falling off. The Bureau of Labor price tables for June showed the first drop in the general index number, clothes and clothing falling from 328 to 314, farm products from 241 to 237, building materials from 293 to 275, and "all commodities" from 247 to 243. For July the index number was 241, for August 231 and for September 226. This was the general downward movement, and as yet there had been no reduction in the volume of bank loans.

It was not credit contraction that forced down prices; the price-structure had become top-heavy. As is always the case in a prolonged period of rising prices, the rise was not uniform for everything, and some classes of buyers were obliged to curtail their purchases. The demand was falling off.

### The Tightening Money Market

It is true that money had been growing tighter; credit was not so easily obtained as a year earlier. Both member banks and Reserve banks had about run the course of credit-expansion possible under the law. The Reserve act requires the Reserve banks to keep a reserve of 40 per cent in gold against note liabilities and of 35 per cent in lawful money against deposit liabilities. In their reports the banks compute the total of their reserves against the total of their liabilities, and in March, 1920, the consolidated statement showed them to have a reserve of about 42 per cent. That was dangerously near the limit, considering that the entire credit structure of the country was dependent upon the Reserve banks.

Moreover, this was in months when the demand for accommodations in normal times is comparatively light. Credit requirements normally expand in the Fall, and anxiety was expressed by well-informed people as to how the necessary demands at that time would be met. On the 17th of May, the Senate adopted with but little discussion and practically no opposition the following resolution, introduced by Senator McCormick:

**Resolved, That the Federal Reserve Board be directed to advise the Senate what steps it purposes to take or to recommend to the member banks of the Federal Reserve System to meet the existing inflation of currency and consequent high prices, and what further steps it purposes to take or recommend to mobilize credits in order to move the 1920 crop.**

### Discount Policy of the Federal Reserve Banks

The next day, May 18, was held the meeting of the Advisory Committee with the Reserve Board (the so-called secret meetıng) to consider how best to deal with the situation, in order that the prospective demands of the Fall season might be properly met.

The member banks at this time were very much extended, borrowing heavily of the Reserve banks in order to meet the requirements of their customers. In November, 1918, 3667 member banks, 42.5 per cent of the membership, sought accommodations of the Federal Reserve banks. This was the largest number of borrowing banks during the war period, but in June, 1920, nearly a year and one-half after the war was over, 4948 member banks, or more than 49 per cent of the membership, were borrowing. That does not indicate a curtailment of accommodations to the public. The greatest number of member banks accommodated in any one month was registered in June, 1921, to wit, 5745, or 59 per cent of the membership.

The entire history of the strenuous period from mid-summer, 1919, to the crisis caused by the fall of prices shows that although the Reserve authorities appreciated the dangers of increasing inflation and made efforts to control it, they were yet so anxious not to deny credit where it was required for the regular business of the country that they allowed loans to continue to increase up to the month of November, 1920.

### The Cause of the Crisis

The crisis was not caused by a contraction of credit but by the fall of prices, which was general over the world and due to the disorganization of industry in Europe and the inability of the European populations to take their accustomed quantities of the products of other countries. Even as late as 1923 the trade of Europe with the rest of the world was down 25 per cent or thereabouts fıom what it was before the war. The spurt of trade which followed the armistice represented a dammed up demand, and could not be sustained.

Once prices began to fall, the entire situation changed from what it was while prices were rising. Instead of an apparent scarcity of goods there developed a plethora. It appeared then that there had been speculation in goods as well as in stocks and lands, and as the speculators saw their margins vanishing they threw what they had on the markets, contributing to the demoralization. Instead of being over-weighted on the buying side, as had been the case for several years, the markets were over-weighted on the selling side, for buyers naturally held off while prices were falling.

Of course there were many instances of borrowers unable to renew their loans, or required to reduce them, and this is what gave plausibility to the theory of deliberate deflation. Numerous victims were in evidence. The real cause of their trouble, however, was that they were doing business on margins and the decline of prices had reduced their margins until the loans they had outstanding were not well secured. Under such conditions banks are obliged to ask for more security or partial payment. That is always a risk of doing business with borrowed capital—a risk which men take for the sake of the gains realized when prices go the other way. For several years prior to 1920 prices had been going upward, and a great many people had known the fascinating experience of making money on marginal investments. The effect was to weaken the entire business situation by filling it with traders who had everything up in margins and were short of reserve resources.

### Danger to the Reserve System

The Reserve system was hampered in the crisis by its intimate relations with the Government. It had been obliged to adapt its policies to suit the policy of the Treasury, with the result that the Reserve banks were

already far gone on the course of inflation before the crisis was reached, although the very purpose of the Reserve banks was to hold resources in reserve for crises. The attacks which they have suffered, the attempt on all sides to drag them into politics, and the proposals which are made to reorganize the system in ways that would make it more serviceable in politics, all show the inherent weakness of any banking system having a governmental connection. Everything with which the Government has to do becomes involved in politics, and subject to partisan controversies and misrepresentation. No banking system can function effectively under such conditions. The more deeply the banks are drawn into politics and administered with a view to political considerations, the more costly will be the results to the public.

As already stated, the pressure of the Treasury upon the Reserve banks to assist in floating a public loan at an abnormally low rate, had the effect of crippling the banks in the emergency service for which they were planned, and cost the country a far greater sum in the end than the Treasury loan would have cost at market rates. The interests of the public have suffered every time the Government has meddled with banking from the time of the first Bank of the United States to the present day.

It is significant that although the Congress appointed the Joint Committee of Agricultural Inquiry, consisting of six members of the Senate and six members of the House, to investigate the conduct of the Reserve banks during the crisis, and this Committee made an exhaustive report to which the names of the full committee membership were appended. practically no attention has been given to the report by members of Congress or the active politicians of either party. The findings of the report are in agreement with the foregoing review, but even some of the committee members who signed them have disregarded them in their utterances since.

## Canadian Railway Rates

In the heavy output of misinformation with which the third party publicity bureau has deluged the country, the Canadian railways have cut a considerable figure. The Canadian National Railways, owned and operated by the government were said to be making a profit and they turned out to be doing so after the fashion of the South Dakota State-owned flouring mills. It was also represented that in Canada freight charges had been reduced to the pre-war rates, the two statements on their face affording a good basis for the La Follette arguments that railroad rates in the United States should be reduced to the prewar level.

In the October Letter we gave the facts as to the deficits of the Canadian National Railroads and as to the enforced reduction of certain rates on the Canadian Pacific system. Briefly stated, the latter case is as follows: In 1897 the Canadian Pacific Company, in consideration of a subsidy which was being granted for what is known as the Crow's Nest extension, agreed with the Dominion government that it would not at any time raise specified rates above a certain maximum, at the time regarded as mutually satisfactory. Nobody was contemplating a great war which would raise all operating costs, and when the war came and the results were apparent the Canadian government by act of Parliament waived this provision of the contract for a definite period. This waiver finally expired this year, and opposition to its renewal developed in the western provinces, with the result that it was not renewed.

The Canadian Pacific company then restored rates to the pre-war level as to commodities named in the Crow's Nest agreement and as between points that were on the system in 1897, but claimed that the agreement was not otherwise binding. The effect was to throw the whole rate situation into great confusion. Localities that were not on the system in 1897 were placed at a disadvantage and protested against the discrimination. Moreover the government-owned competing lines, which already were losing money, were affected wherever they came in contact with the Canadian Pacific.

The case was taken before the Railroad Commission, which has rendered a decision holding that the rate provision of the Crow's Nest agreement has been superseded by the act of Parliament creating the Railroad Commission and fixing its powers.

The present status is set out quite clearly in the following dispatch, which has been received from a responsible Canadian source in response to a request for a statement:

Montreal, P. Q., October 27, 1924.

The governments of the prairie provinces have given notice of their intention to appeal to the Governor in Council from the judgment of the Board, and have, I understand, also applied to the Board for leave to appeal to the Supreme Court on questions of law involved. On appeals to the Governor in Council it is the practise to deal almost always with questions of fact, as obviously the cabinet is not so constituted to permit it to give a decision on points of law. In this case the facts are practically all admitted and the whole dispute centers around the questions of law, i. e., as to whether, in the first place, the rate provisions of the Crow's Nest agreement override the provisions of the General Railway Act giving authority to the Railway Commission to fix just and reasonable rates and prevent unjust discrimination; and secondly if the provisions of the agreement do so prevail, whether its effect is confined to points on the lines of the Canadian Pacific which were in existence in 1897 or whether it is extended to the whole system as it exists today and thirdly, whether, if it is limited to the system of 1897, it is a valid answer to charges of unjust discrimination made by localities

**not within the favored territory or by shippers not within the favored list. Under the judgment of the Railway Commission the so-called Crow's Nest rates have been rescinded and tariffs have been published, effective today, restoring these rates to the level that prevailed before July 7 last. In view of the questions of law involved it is hardly likely that the tariffs containing the higher rates will be interfered with by the Government, and undoubtedly an effort will be made to get the case before the Supreme Court at the earliest possible date.**

**In the meantime the inequalities and causes of acute dissatisfaction as between different industries and different localities have been removed and the situation is much more satisfactory from the standpoint of all concerned than if the Crow's Nest rates had been allowed to remain in effect.**

It will be seen that the Canadian matters exploited by the third party management actually furnish no support for Senator La Follette's proposal to reduce railway rates in the United States to the pre-war level. The Canadian situation is wholly different from what it has been represented to be.

## The Situation in Austria

The newspapers in recent weeks have contained considerable sensational news from Vienna, mostly in connection with the financial affairs of Castiglioni, said to have been Austria's richest man of post-war times. This party's interests were extensive and his failure created considerable confusion, but settlements are being affected which clear up the situation to a great extent and minimize the general effects.

A part of Castiglioni's holdings in Austrian industries has been taken over by foreign financial groups; other financial groups, Austrian and foreign, are proposing to take over the remainder. At the same time an agreement has been reached in regard to Castiglioni's liabilities to the Depositenbank, which was carried down by his embarrassment. The status of the latter bank has improved to such an extent that full payment of all savings accounts has been assured to the depositors. The claims of the partners of the Alcohol Syndicate against Castiglioni are also to be settled in an amicable manner. Castiglioni made a vast fortune very rapidly and lost a large part of it in like manner, but in some quarters confidence is expressed that he will be able to make satisfactory adjustments all around.

The gold reserve of the Austrian National Bank, whose policy is largely responsible for the continued stability of the Austrian currency during the past two years, has further increased in October so that the Austrian banknotes in circulation are now covered to the extent of 50.6%. On the other hand, the item "Bills Discounted" dropped 500,000 million paper Kronen, according to the last statement of the bank.

Savings deposits in all Austrian banks have continued to increase during the months of September and October and amount now to over the sum of 1,500,000 million paper Kronen, which is three times as much as the amount deposited the same time last year.

Trade balance figures up to July of this year are now available and show a reduction of the adverse balance from 97 million gold Kronen in June to 80 million gold Kronen in July; also from round figures of the months of August and September and from reliable estimates, a better trade balance is expected for the second half of the current year.

The total number of unemployed in September was 74,000 against 83,000 at the same time last year.

In October, the high rates of interest, which up to now constituted the greatest handicap for the Austrian industries, began to decline; in consequence whereof, also the official discount rate will be lowered in the near future.

The government has met all the obligations of its agreement with the League of Nations, which is the basis of the foreign loan, and the League has felt warranted in authorizing it to increase its budget of expenditures for the ensuing year. The budget estimate balances except for certain capital expenditures, which will be met in part by a domestic loan.